

## The Economic Policy

At the close of my two years as Finance Minister and after successfully curbing the decline of the Israeli economy, we risked setting long-term vision and goals for the Israeli economy. Our primary aim was to position Israel amid the top ten global economies within 10 to 15 years and not to make do with our present position among the global economies.

The world population is divided into three groups: some five billion people live in underdeveloped countries with per capita income of below \$7,500, three hundred million (including Israelis) live in developing countries with average per capita income and about eight hundred million live in peak countries with per capita income of \$27,000 and more. The per capita income index, more than any other economic index, reflects the economic and social state of a country's population and to a great extent, it encompasses its standard of living and the welfare services it receives.

Small countries such as Ireland and Singapore, which only fifteen years ago were positioned behind us on the per capita income listing, introduced free-market reforms, overtook us and caught up with economic giants such as Britain and Japan. These free-market countries almost eradicated poverty on their way to becoming leading economies. They internalized the fact that only a free-market economy is able to succeed within the global economy. As simply stated by Li Kwan Yew, Singapore's former Prime Minister, when explaining Singapore's reasons for switching to a free market economy: "Communism collapsed and the mixed economy failed. What else was left?"

There is no reason why Israel cannot achieve similar results. We, too, have the power to rapidly climb up the listing and reach the global economic summit. The key lies in combining our nation's immense capabilities and skills with a free economy policy that will provide a new field of activities for the creativity, originality and inventiveness of the Israeli nation.

We are blessed with a talented nation, an inventive mind for discovering new patents, born entrepreneurs, devoted workers, and people from diverse cultures who easily fit in with what is happening around the world. As a result, we benefit from an impressive concentration of reputable high-tech engineers, scientists, technicians and doctors who are able to discover and create products of knowledge, the new source of wealth in the twenty-first century. However, as proven by the economic collapse of the Soviet bloc, an educated population is not enough to ensure growth and prosperity. The other essential condition is a free market economy – in other words, an open and competitive economy that encourages enterprise, investment and hard work. This is the component that was missing from Israel's economy, and this is the big change that our economic program and reforms

aim to generate. For Israel to be one of the world's top economies, it has to adhere to the current policy, which has proven its ability to generate growth, employment, profit and prosperity for all of Israel's citizens.

### What has been done up until now?

The resuscitation plan for the Israeli economy was launched in June 2003, three months after the establishment of the new government. The economy at that time was in a grave recession, the GDP had shrunk for two consecutive years, unemployment rose, wages dropped, the stock exchange crashed and civilian and government interest rates soared.

The economic plan is not only aimed at extricating Israel from its immediate crisis, it is also meant to generate a turnaround which will heal the economy from the malady that is dragging it down and preventing Israel from competing with other countries which have overtaken it over the past two decades. Contrary to widespread belief, the burst of the high-tech bubble and the deteriorating security situation between 2000 and 2003 were not the only causes for the economic problems. Israel was falling behind even before then, because the economy remained monopolistic and bureaucratic, bogged down in taxes and social benefits, while other countries introduced reforms to accelerate their economic competitiveness.

While these economies streamlined, lowered taxes and attracted investors and entrepreneurs, Israel hiked taxes, allocated allowances indiscriminately and held the world record in strike days per worker. The outcome was grave recession, galloping unemployment and a drop in the standard of living.

### The Fat One and the Thin One

In an attempt to illustrate our status within the global economy, I compared the world economy to soldiers in basic training, competing in pairs in a full-gear hike. Each pair represents the productive private sector that will carry both of them to the finish line. The private sector produces most of the economy's added value. It generates growth and jobs, while the public sector is responsible for essential areas such as security, education and welfare. Talented and devoted people serve in the public sector, but over the years, this workforce has expanded excessively, breeding inefficiency, waste and inferior service. In our case, the inflated public sector ("the Fat One") reached terrifying proportions – 55% of the GDP, while the private sector ("the Thin One") kept shrinking. If this trend had been allowed to continue,



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Israel's economy would have collapsed. At the beginning of 2003, we were on the verge of economic collapse.

The obvious conclusion was to urgently diminish the public sector while reinforcing the private sector. This is precisely the policy that we introduced. We simultaneously cut government expenditure and tax rates, steps taken by my predecessor, which we expanded and even added to. We encouraged Israelis to leave the welfare cycle and join the workforce, while repatriating foreign workers. We privatized government companies and banks, and introduced reforms which opened up rigid monopolies to competition, the first being the reform of the ports and the anticipated capital market shake-up. At the same time, we introduced innovative restructuring to save the Histadrut's outdated pension funds from collapse and removed an immense threat to the future stability of the economy.

### Results of reform

These essential reforms, some of which constitute global breakthroughs, have constructively altered the face of the Israeli economy. The purpose of these reforms is to heighten competition and lower prices, a most significant social-economic step from which the lower echelons will be the first to benefit. And above all, these reforms are essential for succeeding in the global competition in which we find ourselves.

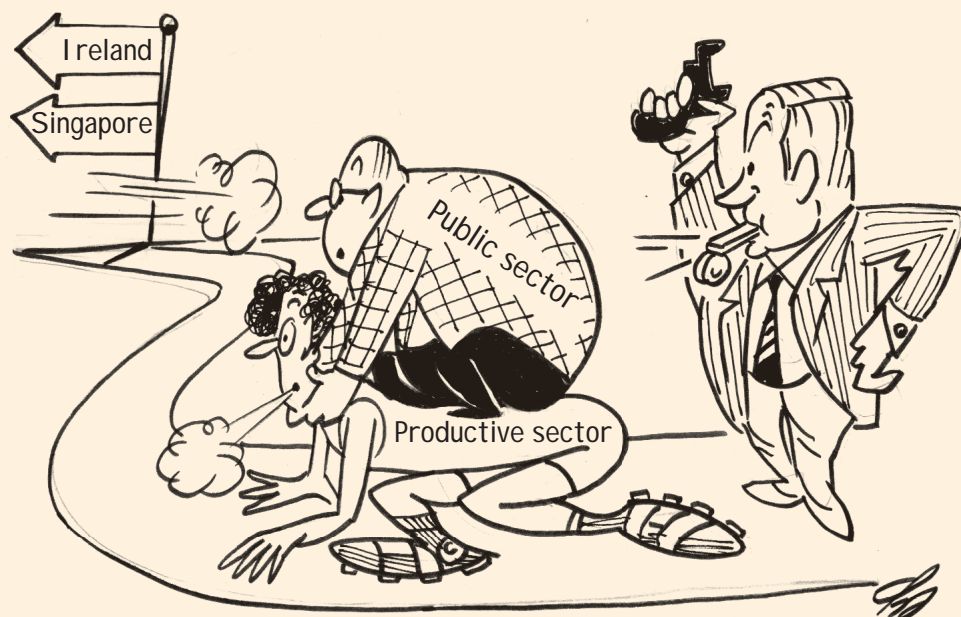
And indeed, the results of these reforms were immediately seen. Economic growth returned and reached 4.2%, unemployment dropped to 9.8% and employment expanded, the average income rose by 2.7%, the capital market achieved all time highs and the government's capital raising costs dropped to the lowest levels ever.

Lower interest rates affected everyone, with the lowest costs on mortgages, overdrafts and loans since the establishment of the State. The outcome, which many doubted, exceeded expectations in all these areas. The international economic community praised this policy, and credit rating agencies upgraded their evaluations of the Israeli economy. This improvement lowers Israel's credit costs, and no less important, attracts international and local investors to Israel, thereby generating new jobs. By meeting the goals of the economic plan, we were able to receive US government financial guarantees that helped us stabilize Israel's economy and reinforce faith in it. At the same time, it should be noted that these guarantees were given gradually and that they are dependent on meticulous implementation of the reforms.

### Social-economic reform

The economic policy has clear social objectives: incentives for those who can work to find jobs and support for those who are unable to work. And indeed, from the outset some 100,000 Israelis were integrated into jobs made available by repatriation of foreign workers as well as new jobs that were created. The growth and the tax reductions (income tax, purchase tax, company tax and VAT) increased tax revenue. This enabled the government to help needy populations such as the elderly (reinstating old-age pensions), children (introducing school nutrition programs) and the sick (expanding the drug basket), as part of the 2005 budget.

A healthy economy does not contradict a strong society. On the contrary, they complement one another. The previous policy of indiscriminate social benefits for people who are able to work as well as for those who are not, was found to be economically



and socially lethal. Additional social benefits led to tax increases, which caused the shrinking or collapse of many factories. As a result, more Israelis dropped out of the workforce and fell into the cycle of unemployment and social benefits, which led to another tax increase and so on. This policy of social benefits and tax increases generated a destructive vicious cycle that only perpetuated and expanded poverty. The new economic policy is also the right social policy. It urges people to leave the cycle of social benefits because it recognizes that rising above the poverty line requires finding a job. As more family members go out to work, the family's economic situation will improve. The program that we introduced reduces taxes because this is the first and most important incentive for achieving growth. The more the economy grows, the more new jobs it generates. And the more jobs in the private sector, the more tax revenue the government collects in order to take care of those who are unable to work.

### Fast transportation to develop outlying areas and bring them closer to the center

The economic policy has another social aspect. Poverty in Israel is mainly concentrated in the outlying areas, the Galilee and the Negev. The fact that such a small country has outlying areas is largely absurd in itself. We intend to eliminate this absurdity by building a fast transportation network of roads and railways to the Negev and the Galilee, including a railway line that will finally connect Eilat and the Negev to the center of the country. These steps will be accompanied by restructure of the National Planning Authority and Israel Lands Administration in order to make land for construction less expensive and more available in the north and south. The economic, social and demographic conditions in these regions will change beyond recognition once young couples will be able to buy a single-family home in the Galilee or the Negev and travel to work in the large centers in under an hour.

Furthermore, we are planning large tourist ventures for these areas. International tourist resorts combining entertainment, gambling and hotels will be established in the Eilat area, and later on further north. Meanwhile, special global-standard resorts will be established around the Lake of Galilee to attract Evangelistic tourists from various countries, a public currently numbering over 100 million, most of them high-income populations. These ventures will provide a livelihood for many Israelis in the north and the south.

A healthy economy is essential for all aspects of our national life, and our long term security depends on it. We have seen how the second largest military force in the world, the Soviet Red Army, disintegrated as a direct result of the breakdown of the Soviet Union's economy. A free and innovative economy is a fundamental condition for the existence of a strong modern military force. The introduction of the new economic policy

facilitated allocation of billions of shekels for construction of the security fence, which drastically reduced terrorism and boosted economic growth. Security contributes to the economy and the economy contributes to security. It is clear that if and when we reach a stable peace agreement with our neighbors, this will further contribute to economic growth – providing that we continue to adhere to a free market economy policy. Peace in itself, without an appropriate economic policy, cannot lead to economic salvation.



### The need to persevere

The positive turnabout of the Israeli economy must not be temporary. In order to permanently eradicate poverty and unemployment, Israel must consistently and persistently stick to the current economic policy. Even if this involves difficulties and even if it leads to temporary deterioration of poverty indices, caused by the transition period and adaptation of certain groups to a work culture, we have no choice but to persevere with this policy and overcome the difficult phases, most of which are already behind us. The positive outcome of the economic turnabout and the renewed economic growth is already impacting the lives of many families who have integrated into the workforce, as well as others who have improved their financial status. The fruits of economic growth will only reach all parts of the country and every level of society if we adhere to the current economic policy. This is the only way that we will be able to reduce poverty, just as other countries that have introduced market reforms have managed to do. Israel can reach the summit of the nations leading in per capita income. Results of the past two years indicate that we are able to attain this goal and to relegate the crisis from which we are emerging to the past.

This article was written during Netanyahu's tenure as Finance Minister